RECENT INTELLECTUAL PROPERTY-RELATED INVESTIGATIONS, ADVOCACY, AND RESEARCH AT THE U.S. FEDERAL TRADE COMMISSION

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Antitrust issues involving intellectual property (IP) have long been an important part of the U.S. Federal Trade Commission's (FTC's) enforcement, advocacy, and research agendas. Most recently, the FTC has brought several enforcement actions and engaged in competition advocacy and study involving standard-essential patents (SEPs), patent-assertion entities (PAEs), and pay-for-delay settlement agreements. This paper sets forth the Commission's general approach to IP matters, focusing on recent developments involving SEPs, PAEs, and pay-for-delay.

I. The FTC's General Approach to Competition Matters Involving IP

The FTC's approach to enforcement in matters involving IP is grounded in the core principles of the 1995 joint FTC-Department of Justice's Antitrust Division (DOJ) Antitrust Guidelines for the Licensing of IP (DOJ-FTC IP Guidelines).[1] Specifically, the Commission recognizes that antitrust and IP are complementary bodies of law that both seek to promote innovation and enhance consumer welfare. The antitrust laws promote innovation and consumer welfare by protecting the competitive process and prohibiting certain actions that may harm competition. Strong IP rights strengthen the competitive process by providing incentives for innovation and its dissemination and commercialization by establishing enforceable property rights.

The 1995 Guidelines embody three general principles:

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[1] DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), *available at* http://www.justice.gov/atr/public/guidelines/0558.pdf ("DOJ-FTC IP GUIDELINES").

(1) for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property;
(2) the Agencies do not presume that intellectual property creates market power in the antitrust context as there will often be sufficient actual or potential close substitutes to prevent the exercise of market power; and
(3) the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive.[2]

In the vast majority of cases, the U.S. Antitrust Agencies will apply a rule of reason analysis to restraints in intellectual property licensing arrangements. "The Agencies' general approach in analyzing a licensing restraint under the rule of reason is to inquire whether the restraint is likely to have anticompetitive effects and, if so, whether the restraint is reasonably necessary to achieve procompetitive benefits that outweigh those anticompetitive effects."[3] In some cases, however, the Agencies may apply a per se approach when a restraint's "nature and necessary effect are so plainly anticompetitive" that it should be treated as unlawful per se, without an elaborate inquiry into the restraint's likely competitive effect (e.g., naked price-fixing, output restraints, market division among horizontal competitors, and certain group boycotts).[4]

II. Recent FTC Enforcement Involving FRAND-Encumbered SEPs

One area in which the FTC has been active in recent years involves SEPs encumbered by a commitment to license on fair, reasonable, and nondiscriminatory (FRAND) terms. The FTC recognizes that standard setting is generally procompetitive and has intervened in such matters only when there is sound economic evidence of likely anticompetitive effects.[5] To that end, the FTC has exercised its enforcement authority only in the limited circumstances when a patent holder has knowingly and deceptively failed to disclose patents essential to

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[2] 1995 Guidelines § 2.1.
[3] *Id.* at § 3.4.
[4] *Id.* (internal citation omitted).
[5] *See* Remarks of FTC Chairwoman Edith Ramirez, "Standard-Essential Patents and Licensing: An Antitrust Enforcement Perspective," 8th Annual Global Antitrust Enforcement Symposium, Georgetown University Law Center at 7 (Sept. 10, 2014), *available at* https://www.ftc.gov/system/files/documents/public_statements/582451/140915georgetownlaw.pdf [hereinafter 9/10/14 Remarks of Chairwoman Ramirez].

a standard to avoid a FRAND commitment, or when a patent holder has engaged in patent-hold by seeking injunctive relief against a willing licensee.[6]

A. Hold-Up, Reverse Hold-Up, and Hold-Out

The threat of hold-up arises from the difficulty and expense of switching to a different technology once a standard is adopted. This potential for "lock-in" can confer market power on the owners of the patents that are essential to a standard. When that occurs, the patent holder can demand licensing terms that it may not have had the power to obtain in a competitive environment before the standard was adopted. To address the risk of hold-up, standard-setting organizations (SSOs) often seek voluntary commitments from patent holders to license their SEPs on FRAND terms.

In addition, several market-based factors mitigate the risk of hold-up. For example, reputational and business costs may deter repeat players from engaging in hold-up and "patent holders that have broad cross-licensing agreements with the SEP-owner may be protected from hold-up."[7] In addition, patent holders often enjoy a first-mover advantage if their technology is adopted as the standard. "As a result, patent holders who manufacture products using the standardized technology 'may find it more profitable to offer attractive licensing terms in order to promote the adoption of the product using the standard, increasing demand for its product rather than extracting high royalties.'"[8]

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[6] For a summary of FTC enforcement involving deceptive failure to disclose essential patents, see Section 3.1 of the Note by the United States on "Intellectual Property and Standard Setting," submitted to the OECD Competition Committee on December 8, 2014, *available at* http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2014)116&doclanguage=en [hereinafter 2014 USG OECD Paper].

[7] Prepared Statement of The Federal Trade Commission Before the U.S. Senate Committee on the Judiciary Concerning "Standard Essential Patent Disputes and Antitrust Law" at 6 (July 30, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf [hereinafter 7/30/13 Prepared Statement of the FTC].

[8] *Id.* (quoting Fed. Trade Comm'n & U.S. Dep't of Justice, "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition" at 40-41 (2007), *available at* http://www.ftc.gov/sites/default/files/documents/reports/antitrust-enforcement-and-intellectual-property-rights-promoting-innovation-and-competition-report.s.department-justice-and-federal-trade-commission/p040101promotinginnovationandcompetitionrpt0704.pdf)).

As the United States Government recently explained in its 2014 submission to the Organization for Economic Cooperation and Development (OECD), standard setting also raises potential concerns about reverse hold-up and hold-out.[9] "Reverse hold-up" refers to the situation when a licensee uses its leverage to obtain below-FRAND rates and terms. "Hold-out" refers to the situation when a licensee either refuses to take a FRAND license or delays in doing so. Without the availability of relatively prompt and effective civil remedies, including injunctive relief in appropriate circumstances, patent holders that seek compensation for the patented technology they contribute to a standard may not be compensated for their innovations in a way that reflects the appropriate value of the technology. In the absence of the ability to obtain such compensation, patent holders may become reluctant to contribute technology to a standard or to invest in future research and development that leads to further innovation.[10]

B. Enforcement Involving Seeking Injunctive Relief on FRAND-Encumbered SEPs

In 2013, the FTC settled two enforcement actions, one against Bosch[11] and the other against Motorola Mobility and Google,[12] which resulted in consent orders that prohibit the companies from seeking or enforcing injunctive relief on FRAND-encumbered SEPs against willing licensees.

In *Motorola Mobility/Google*, the FTC alleged that Motorola and Google violated the "unfair methods of competition" provisions of Section 5 of the FTC Act by seeking and enforcing injunctions on FRAND-encumbered SEPs against willing licensees.[13] The Commission stated that "[s]eeking and threatening injunctions against willing licensees of FRAND-encumbered SEPs undermines

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[9] 2014 USG OECD Paper Section § 2.4 at 7-8.
[10] *Id.*
[11] Decision and Order, *In the matter of Robert Bosch GmbH*, File No. 121-0081 (F.T.C. April 24, 2013), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2013/04/130424robertboschdo.pdf.
[12] Decision and Order, *In the Matter of Motorola Mobility LLC and Google, Inc*., File No. 121-0120 (F.T.C. July 24, 2013), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2013/07/130724googlemotorolado.pdf [Consent and Order, *Motorola Mobility/Google*].
[13] Complaint, *In the Matter of Motorola Mobility LLC and Google, Inc*., File No. 121-0120 (F.T.C. July 24, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/07/130724googlemotorolacmpt.pdf.

the integrity and efficiency of the standard-setting process and decreases the incentives to participate in the process and implement published standards."[14] To remedy the alleged Section 5 violation, the Commission entered into a consent order that, broadly speaking, prevents Motorola and Google from using injunctions or threats of injunctions against current or future potential licensees who are willing to accept a license on FRAND terms and lays out a resolution process that Google must take before seeking an injunction on FRAND-encumbered SEPs.

Importantly, the FTC's consent order permits Motorola Mobility and Google to seek or enforce injunctive relief when the alleged infringer:

(1) is outside the jurisdiction of the United States;

(2) has stated in writing or in sworn testimony that it will not license the FRAND patent on any terms;

(3) refuses to enter a license agreement on terms that have been set by a court or through binding arbitration;

(4) does not provide a written binding commitment to license on FRAND terms; or

(5) itself seeks injunctive relief on a FRAND patent against the SEP holder (i.e., a defensive use exception).[15]

C. Limiting Principles

The FTC recognizes that imposing liability for merely refusing to share IP, or license at a particular rate, undercuts the procompetitive value that a strong system of IP rights provides. As FTC Chairwoman Ramirez recently stated, to promote efficient investment in the development of new technologies, firms should be free to determine the best way to maximize the value of their IP.[16] Thus, in contrast to the approach taken in some countries, the FTC has not sought to impose liability based solely on the royalty terms that a patent owner demands for a license to its FRAND-encumbered SEPs, or royalty demands for licenses to

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[14] Analysis of Proposed Consent Order to Aid Public Comment, *In the Matter of Motorola Mobility LLC and Google, Inc.*, File No. 121-0120 at 2 (F.T.C. Jan. 3, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/01/130103googlemotorolaanalysis.pdf.

[15] Consent and Order, *Motorola Mobility/Google* § II.E. at 8 and § IV.F. at 12.

[16] 9/10/14 Remarks of Chairwoman Ramirez at 3, 8-9.

other patents that may not be subject to a voluntary FRAND commitment. This is because the U.S. antitrust laws do not prohibit "excessive" pricing.

III. FTC PAE Study and Workshop

Another area in which the FTC has been active concerns conduct by PAEs, which the FTC defines as firms with a business model based primarily on purchasing patents and then attempting to generate revenue by asserting the IP against persons who are already practicing the patented technologies.

A. FTC PAE Study

While we have all heard troubling anecdotes about PAE activity, they do not tell us much about the competitive costs and benefits of PAE activity. In order to shed more light on this activity the FTC is conducting a study to expand the understanding of PAE activity and its likely costs and benefits.[17]

The study has two parts: the first part is a broad examination of the PAE business model; the second is a more tailored case study of PAE activity in the wireless industry sector. For the broad analysis, the FTC has sent requests for information to roughly twenty-five PAEs seeking information such as:

- the composition of PAE portfolios,
- whether the patents are essential to any standards or encumbered by other licensing obligations,
- the costs of acquiring patents, and
- whether the PAEs share an economic interest in its portfolio with other entities.

For the narrower case study focused on the wireless chipset sector, the FTC has sought information from other types of licensors, such as manufacturers, to help the FTC understand what drives the PAE business model, and what increasing activity by PAEs may mean for innovation and consumers.

B. FTC-DOJ Workshop on PAE Activity

[17] FTC Patent-Assertion Entity Study, https://www.ftc.gov/policy/studies/patent-assertion-entities-pae-study.

Prior to embarking on its current PAE study, in December 2012, the FTC and the DOJ hosted a workshop on PAE activities.[18] The workshop included speeches and presentations by regulators, economists, and high-tech industry participants, and fostered discussion and debate about the effect of PAEs, and whether the antitrust laws should be brought to bear in regulating PAE activity.

Some participants criticized PAEs and their effect on competition and innovation, while others argued that PAEs offer a path to monetization for individual inventors, which can spur innovation. Most panelists seemed to agree that any measures aimed at addressing abusive conduct should focus on the conduct and not the business model. There was lively debate about the positive and negative effects of PAEs, but many participants agreed that a bottom-line assessment is difficult because of the lack of reliable data regarding the amount of PAE litigation and the outcome of those cases. Speakers at the workshop blamed the scarcity of data on several factors, including the lack of transparency regarding patent ownership makes it difficult to track litigation, and the confidentiality provisions in licensing agreements obscure the outcome of demand letters and settlement negotiations.

A primary focus of the workshop was whether and how the antitrust laws should apply to conduct by PAEs. To spur discussion, the agencies posed three hypothetical scenarios. The most straightforward scenario involved a PAE purchasing patents from an operating company with the intent to monetize more aggressively than the operating company in the absence of an operating company's reputational (or business relationship) constraints or need for cross-licenses. Although many panelists had reasons why such a transaction could raise costs for consumers—for example by disaggregating the operating company's portfolio and creating a royalty stack for downstream manufacturers—they were hard-pressed to describe how the antitrust laws would operate to prohibit acquisition and aggressive enforcement by a "pure" PAE. As a transaction between an operating company and a non-practicing entity, the panelists opined that this type of acquisition would be unlikely to result in scrutiny under Section 7 of the Clayton Act, and that asserting patents in good faith cannot be a violation of the antitrust laws, not least because of protection under the *Noerr-Pennington* doctrine, which shields from liability parties who petition the government for the redress of grievances (including through litigation).

[18] To access the workshop agenda, transcript, video, and public comments, see https://www.ftc.gov/news-events/events-calendar/2012/12/patent-assertion-entity-activities-workshop.

A second hypothetical situation involved a "hybrid" PAE—that is, a PAE with a relationship to an operating company. In this scenario, the agencies posited that the PAE would purchase a portfolio from an operating company under terms that would align the PAE's interests with the operating company's, such that the PAE would selectively enforce the patents against the operating company's rivals, thus raising the rivals' costs. In this case, many of the panelists agreed that the transaction itself might be scrutinized under Section 7 of the Clayton Act, and blocked (assuming it was reportable) or challenged after consummation (assuming no Hart-Scott-Rodino merger filing requirement).

The third hypothetical posited that two operating companies would jointly create a PAE with interests aligned with those of the operating companies. There seemed to be general agreement that this arrangement would be the most likely to attract antitrust scrutiny. In addition to raising similar issues to those raised by the prior hypothetical, this scenario might also allow two competing operating companies to conspire to shield weak patents, thus raising issues under Section 1 of the Sherman Act.

Outside of the agencies' hypotheticals, there was discussion of certain "plus factors" that might give rise to antitrust liability, even in a "pure" PAE situation. For example, if a patent assertion entity were to acquire a massive portfolio and require targets to take a license to the entire portfolio, this could raise antitrust issues. If a "pure" PAE were to acquire standard-essential patents and then renege on the original owner's FRAND licensing commitment, this would also raise flags.

Although the workshop participants did not reach any firm conclusions regarding the application of the antitrust laws to PAE activity, there seemed to be general agreement that non-antitrust-specific measures might also help address PAE conduct. Specifically, panelists advocated for improvements to patent quality and clarity, and for judicial reforms such as fee-shifting and limitations on injunctions and exclusion orders.

IV. FTC Enforcement Involving Pay-for-Delay Settlement Agreements

The Commission has been particularly active in scrutinizing pay-for-delay settlement agreements. Since the issue first arose in 1998, these agreements have been a priority for the Commission. Pay-for-delay settlements, also known as "exclusion payment" or "reverse payment" settlements, are settlements of patent litigation in which the brand-name drug manufacturer pays its potential generic competitor to abandon a patent challenge and delay entering the market with a lower cost generic product. The core concern with these agreements is that they

can allow the brand to prevent the risk of competition by sharing monopoly profits with the prospective entrant.

To develop a better understanding of the competitive implications of such agreements and to aid in our enforcement efforts, the FTC has conducted several empirical studies of the pharmaceutical industry. In one study of the U.S. pharmaceutical industry as a whole, the FTC found that a branded manufacturer typically loses about 90% of its unit sales over the course of generic entry.[19] While generic entrants gain that unit volume, they do not gain all the revenues lost by the branded manufacturer because, as generic competition sets in, the price falls, on average to about 15% of what the branded manufacturer was charging. Thus, a branded manufacturer can expect that, if a drug is earning $1 billion a year before generic entry, the manufacturer will only earn about $100 million a year once generic competition has matured, and all the generic companies put together will only earn about $135 million a year, thus leaving approximately $765 million a year for the purchasers through the benefits of competition. The parties have a strong economic incentive to avoid that result.

In June 2013, the FTC achieved a significant victory when the U.S. Supreme Court, in *FTC v. Actavis*, agreed with the FTC that there is reason for concern that reverse-payment settlements tend to have significant adverse effects on competition, and held that such settlements are subject to antitrust scrutiny under a rule of reason analysis.[20]

Since *Actavis*, the FTC has continued to pursue pay-for-delay matters in federal court litigation, investigate pay-for-delay matters, and engage in competition advocacy, such as filing amicus briefs in private litigations alleging pay-for-delay agreements. The Commission is currently litigating three pay-for-delay matters in federal court.

The first matter is the *Actavis* case in which the FTC is challenging an agreement between Solvay Pharmaceuticals and two generic drug manufacturers in which Solvay paid for the delayed release of generic equivalents to its own testosterone-replacement drug, AndroGel. Specifically, the Commission alleges that, in an effort to prevent the two generic drug manufacturers from acquiring

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[19] PAY-FOR-DELAY: HOW DRUG COMPANY PAY-OFFS COST CONSUMERS BILLIONS: A FEDERAL TRADE COMMISSION STAFF STUDY at 8 (Jan. 2010), *available at* https://www.ftc.gov/sites/default/files/documents/reports/pay-delay-how-drug-company-pay-offs-cost-consumers-billions-federal-trade-commission-staff-study/100112payfordelayrpt.pdf.

[20] 133 S.Ct. 2223 at 1237 (2013).

patents for their competing testosterone replacement drugs, Solvay paid the companies to delay entry for a nine-year period, ending in 2015.[21]

The second matter, against brand-name drug manufacturer Cephalon, alleges that the company prevented competition to its branded drug Provigil by, among other things, paying four generic drug manufacturers in excess of $200 million to abandon their patent infringement suits against the company, and to refrain from selling generic versions of Provigil until 2012.[22]

In Cephalon, which is set to go to trial on June 1, 2015, the FTC recently won its opposition to the defendants' motion for summary judgment. Specifically, the court rejected the defendants' contention that, under the Supreme Court's decision in *Actavis*, plaintiffs must establish that the reverse payment is both large and unjustified as a threshold matter, and failure to meet this burden prohibits analysis under the rule of reason. The court held that *Actavis* requires no such "threshold burden" but instead "primarily instructs that the familiar antitrust rule of reason analysis be applied to cases challenging reverse payment settlements."[23] "Rather, Plaintiffs must present evidence of a large reverse payment as part of their initial burden of demonstrating anticompetitive effects under the rule of reason."[24]

In determining what constitutes a "large payment," the court stated that, while *Actavis* did not identify any specific formula for determining what constitutes a large payment, the court finds that *Actavis* "supports" the plaintiffs' approach, i.e., that "a reverse payment is sufficiently large if it exceeds saved litigation costs and a reasonable jury could find that the payment was significant enough to induce a generic challenger to abandon its patent claim."[25]

The third matter, which the Commission filed in September of last year, alleges that a brand manufacturer, AbbVie, entered into an unlawful pay-for-delay

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[21] *See, e.g.*, Brief for the Petitioner, *FTC v. Actavis*, Case No. 12-416 at 56 (Jan. 22, 2013), *available at* http://sblog.s3.amazonaws.com/wp-content/uploads/2013/01/12-416tsUnitedStates.pdf.

[22] Plaintiff FTC's First Amended Complaint, *FTC v. Cephalon* ¶ 3 (Aug. 12, 2009), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2009/08/090812cephaloncmpt.pdf.

[23] Memorandum Opinion, *FTC v. Cephalon*, Case No. 2:08-cv-2141 at 2 (Jan. 28, 2015) (*available at* http://business.cch.com/ald/KingDrugvCephalon01292015.pdf.

[24] *Id.* at 2-3.

[25] *Id.* at 22.

settlement with a generic drug marketer Teva. The FTC's complaint also alleges that AbbVie engaged in sham litigation by filing baseless patent infringement lawsuits against generic drug marketers Teva and Perrigo to delay U.S. Federal Drug Administration approval of a generic version of AndroGel and extend the monopoly profits for the branded version.[26]

Post-*Actavis*, one of the main issues in pay-for-delay matters in the United States has been whether non-cash payments can constitute an unlawful pay-for-delay agreement. Historically, pay-for-delay agreements often took the form of outright cash transfers. Today, after years of antitrust scrutiny, a brand-drug company may induce a generic company to stay out of the market by offering it payments in kind rather than in cash (e.g., no-authorized generic agreements, complex supply agreements, and marketing agreements). The FTC's position, which several courts have adopted, is that, as a matter of economics, non-cash payments in exchange for delay raise the same antitrust concerns as cash payments.[27] Significantly, the Supreme Court in *Actavis* did not distinguish among forms of compensation that can lead to potentially problematic reverse-payment settlements.

Another key issue post-*Actavis* is whether a court must determine the merits of the underlying patent dispute. The FTC reads *Actavis* to say that the underlying patent merits are irrelevant to the antitrust analysis, which instead turns on whether the brand-name company made a large and unexplained payment to a generic company in exchange for the generic's settlement of the underlying patent litigation. In the FTC's view, the Supreme Court in *Actavis* rejected the argument that many defenders of reverse-payments had advanced for years, that the branded drug company's patent rights justified conduct that violates the antitrust laws. Instead, the court specifically stated that "the size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself."[28]

V. Going Forward

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[26] *See* Complaint, *FTC v. AbbVie*, Case No. 2:14-cv-05151 (E.D.Pa. Sept. 26, 2014), *available at* http://www.ftc.gov/system/files/documents/cases/140908abbviecmpt1.pdf.
[27] *See, e.g.*, FTC Amicus Brief, *In re Lamictal Direct Purchaser Antitrust Litig.*, Case No. 2:12-cv-00995 (D.NJ Oct 5, 2012), *available at* https://www.ftc.gov/sites/default/files/documents/amicus_briefs/re-lamictal-direct-purchaser-antitrust-litigation/121005lamictalamicusbrief.pdf.
[28] *Actavis*, 133 S.Ct. at 1236-37.

The FTC is likely to continue to be active in matters involving IP, continuing to recognize that licensing agreements are generally procompetitive, and limiting enforcement to matters involving likely anticompetitive effects.